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January 29, 2001

The Honorable Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102-0360

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Missouri Public
Service Commission

Re: Case No. GO-2000-394

Dear Judge Roberts:

Enclosed for filing please find the original and eight copies of a Response to Staff Reply.

Would you please see that this filing is brought to the attention of the appropriate Commission personnel.

Thank you.

Sincerely,

NEWMAN, COMLEY & RUTH P.C.

By: Mark W. Comley
Mark W. Comley

MWC:ab
Enclosure
cc: Doug Micheel, Office of Public Counsel
Thomas R. Schwarz, General Counsel's Office
Michael C. Pendergast

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter Laclede Gas Company's)
Experimental Price Stabilization Fund.) Case No. GO-2000-394

RESPONSE TO STAFF'S REPLY

COMES NOW Laclede Gas Company ("Laclede" or "Company") and for its Response to Staff's Reply in the above-captioned case, states as follows:

1. On December 22, 2000, the Staff of the Public Service Commission of the State of Missouri ("Staff") filed a Recommendation in the above-captioned case. In its filing, the Staff asserted that the Experimental Price Stabilization Fund ("PSP") approved by the Commission in Case No. GO-98-484, "is no longer appropriate in current market conditions…." Staff Recommendation, p. 3. Staff therefore recommended that the Commission "terminate the third year of the PSP, and advise Laclede to make the necessary gas purchasing decisions required to fulfill its obligations to provide safe and adequate service at just and reasonable rates."

2. On January 5, 2001, Laclede filed its Response to Staff's Recommendation in which it asserted that there was absolutely no policy justification for terminating the third year of the PSP. Among other things, Laclede noted that as a result of its efforts under the PSP, it had increased the value of its portfolio of financial instruments by more than six fold during the past several months. Specifically, Laclede indicated that by procuring and holding financial instruments until the last three business days of the month before they expired, it had achieved some $11.5 million dollars in financial gains as of December, 2000, and that by trading options throughout the month, it had achieved

another $17 million of savings under the Cost Reduction Incentive component of the program. In short, the Company had, as of the date of its Response, converted the $4 million initially authorized under the PSP into more than $28.5 million dollars in financial benefits.

3. Despite these benefits, the Staff nevertheless filed a Reply to Laclede's Response on January 23, 2001 in which it renewed its contention that the PSP is flawed and should be eliminated.[1] In support of its position, Staff takes little note of the very real and very substantial benefits that have, in fact, already been achieved by the Company under the PSP. Instead, it focuses on explaining why it believes various aspects of the PSP are not, at least in Staff's view, ideally suited to producing the kind or level of price protection that Staff would apparently prefer. Staff concludes by suggesting that the Commission do with Laclede's hedging program what Staff recommended it do with Missouri Gas Energy's hedging program -- namely, eliminate it and simply advise the Company that it should take whatever steps it believes are appropriate for subsequent review in the future.

4. Laclede respectfully submits that the Staff's proposed solution is no solution at all. Nor is it a "policy" by anyone's definition. Whatever criticisms one may wish to level at the PSP, the fact remains that this innovative program has resulted in concrete benefits that far exceed its costs. Moreover, it has done so under not only very

[1] Although the Staff states at page 2 of its Response that the level of benefits calculated by the Company is "curious," it does not assert, after reviewing the Company's workpapers, that the calculation is in any way inaccurate. Indeed, Staff simply observes that the cost savings achieved by the Company through the intra-monthly trading of financial instruments "appear to be greater than the total authorized cost of the program." Such cost savings to date are indeed some $13 million greater than the total amount authorized under the program (i.e., $17 million in savings minus $4 million authorized). However, since the Cost Reduction Incentive component of the PSP explicitly contemplated that cost savings achieved through intra-monthly trading could produce benefits in excess of the authorized cost of the program, Laclede does not understand why the Staff would consider such a result "curious" now that it has occurred.

problematic circumstances, but also under the exact scenario of rising gas prices that the program was designed to address. The approach recommended by Staff has, of course, also been recently tested and, for whatever reason, has resulted in the complete lack of any hedging protection for the state's second largest local distribution company. Given these divergent outcomes, it is difficult to understand what possible policy basis there could be for adopting Staff's recommended approach in this case. Disregarding an approved, workable hedging program for an uncertain, standardless process that has demonstrably not worked would be a poor tradeoff for the Company's customers under the best of circumstances. It makes even less sense, however, to contemplate such an action at a time when the need for workable hedging programs has never been greater.

5. Nor is such an action warranted by the various criticisms that have been leveled against the PSP in Staff's Reply. Indeed, it is disappointing that the Staff would continue to criticize the PSP at all in light of the fact that it has produced substantially more benefits than would have been the case had the Commission adopted the hedging program that Staff proposed at the time the Company's proposed PSP was approved. *See* Case No. GO-98-484. As Laclede has previously pointed out, under Staff's recommended hedging approach in Case No. GO-98-484, the Company would have been precluded from purchasing any financial instruments with strike prices above $4.00 per MMBtu. Given the market conditions and prices which have existed over the past ten months, this ceiling would have effectively precluded the purchase of *any* financial instruments by Laclede for this winter heating season. Under such circumstances, it is not unreasonable to expect that Staff's continued criticisms of the PSP would at least be tempered by the realization that the PSP has proved to be a far superior alternative to

what Staff itself proposed, producing as it has tens of millions of dollars in additional benefits above what would have been achieved had Staff's concept of a proper hedging program been accepted by the Commission.

6. In any event, the Company believes that Staff's criticisms of the PSP are unfounded and that their lack of merit is readily apparent. For example, at page 2 of its Reply, the Staff implies that had the Company purchased financial instruments in March or April it could have realized even greater gains under the PSP and that the Company may not have done so because of a desire to take advantage of the incentive features of the PSP. As Laclede explained in detail in its July 25, 2000 filing in this case, however, the Company's actions at the time were based solely on its perception that the market for financial instruments was overpriced -- a view that appears to have been fully shared by the Staff. Indeed, immediately prior to the period cited by Staff, the Company had just concluded the first year of the PSP, during which it had focused its efforts on obtaining catastrophic price protection for as much of its winter flowing supplies as possible. Despite these efforts and the absence of any material gains under the program, the Staff nevertheless filed a recommendation in this case on February 9, 2000, in which it suggested that Company may have acquired too much protection for its customers at too high a price (i.e., then around $4.00 per MMBtu).

7. In view of these criticisms, and in light of the advice given by its consultants that prices were likely to decline, the Company did not believe it was advisable to make an immediate purchase of financial instruments that, from the outset of the second year of the program, would have produced strike prices 15% or more (i.e., $4.70 to $5.20 per MMBtu) above the prices that Staff had declared too high less than a

month before. The fact that such prices were nearly $2.50 per MMBtu (or more than 100%) higher than the fixed commodity price that Staff and Public Counsel were recommending at the time be approved by the Commission to trigger another gas utility's obligation to lock-in gas prices (See Re: Missouri Gas Energy, Case No. G0-2000-705, Stipulation and Agreement), also weighed in the Company's decision to defer its purchases. Given these considerations, it is unfair to suggest that the Company's actions were motivated by factors other than a desire not to purchase instruments at prices well above anything that Staff and others were willing to recommend as reasonable at the time.

8. Staff's assertion at pages 2-3 of its Reply that the PSP is flawed because customers will lose protection in a rising market and the Company will profit in a declining market is also inconsistent with the historical record. As noted above, customers will receive substantial benefits this year as a result of the Company's efforts under the PSP even though market prices were generally rising throughout the period when those benefits were generated. Moreover, it was during the first year of the program when market prices were low or declining that the Company made no material gains under the PSP. In short, Staff's theories are not supported by reality.

9. Staff's criticisms do, however, serve to reaffirm why a program like the PSP, with its clearly known standards and parameters for procuring financial instruments, is absolutely essential. If the past several months have demonstrated anything, it is that the costs and financial consequences of hedging or locking in prices for gas supplies can be extremely large. Indeed, taking into consideration all financial impacts, the costs associated with hedging or locking in prices can easily climb to levels that, if not recovered, would wipe out most, if not all, of the LDC's net income for an entire year. In

fact, depending on the kind of financial instruments used, such impacts could exceed the LDC's net income by 200%, 500% or more. It is simply unrealistic to expect LDCs, or any other business enterprise, to risk potential disallowances of this magnitude (i.e., particularly if prices decline below the hedged or fixed price) based on an after-the-fact review process that provides no standards beforehand on what will be deemed reasonable. Moreover, by leveling one criticism after another at the PSP, and even recommending that it be eliminated despite the fact that it has produced benefits substantially in excess of its costs, the Staff has only underscored such risks. For if the Staff (and ultimately the Commission) are unwilling to support and continue a hedging program that has produced substantial and demonstrable benefits in a rising market, why should LDCs conclude that the Staff will support recovery of the cost of a hedging program that ultimately ends up producing no financial benefits and, in fact, only imposes costs because market prices have declined. Simply put, if workable solutions to the financial pressures brought about by today's market for natural gas supplies are to be found, and Laclede believes such solutions must be found, it is imperative that all parties work together in a constructive manner to fashion more, rather than fewer, programs like the PSP.

10. To that end, the Company has no objection to Staff's request that the Commission schedule a hearing or other formal presentation in early February in the event it has any remaining concerns or questions regarding the PSP. To the contrary, Laclede would welcome the opportunity to discuss these and other issues relating to gas prices directly with the Commission, whether such an opportunity arises in this case or in some other forum. Moreover, as it has in the past, Laclede will at the appropriate time suggest modifications to the PSP if and to the extent it believes such modifications are

needed to respond to future market developments. Laclede is acutely aware of the challenges facing the Commission as it honors its fundamental obligation to ensure the continued availability of natural gas service to Missouri consumers at just and reasonable prices and wishes to play as constructive a role as possible in that endeavor.

Wherefore, for the foregoing reasons, Laclede respectfully requests that the Commission reject Staff's recommendation to eliminate the third year of the PSP and joins in Staff's request that the Commission schedule a hearing or other formal presentation in the event the Commission has any remaining questions or concerns regarding this innovative program.

Respectfully submitted,

Michael C. Pendergast by R.A.C

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CERTIFICATE OF SERVICE

Michael C. Pendergast, Assistant Vice President and Associate General Counsel for Laclede Gas Company, hereby certifies that the foregoing Response to Staff's Reply has been duly served upon the General Counsel of the Staff of the Public Service Commission, Office of the Public Counsel and all parties of record to this proceeding by placing a copy thereof in the United States mail, postage prepaid, or by hand delivery, on this ____ day of January, 2001.

/ Mark A. Conley